SUPREME COURT, U. S.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1974

**No. 74-1283**

C. N. S. ENTERPRISES, INC., THOMAS G. COULES AND CLAYTON NASSOS,

*Petitioners,*

*vs.*

G. & G. ENTERPRISES, INC., GISELLE STRAUSBURGER, GLADYS LUCAS, KIMLIS SALES COMPANY, ROBERT W. CASEY AND NATIONAL BANK OF AUSTIN,

*Respondents.*

## RESPONSE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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Respondents G. & G. Enterprises, Inc., Giselle Strausburger, Gladys Lucas, Kimlis Sales Company, Robert W. Casey and National Bank of Austin, defendants-appellees in the court below, pray that the Petition for Writ of Certiorari be denied.

### QUESTIONS PRESENTED.

1. Where, to consummate the purchase of a business, a purchaser borrows money from a bank and issues its note therefor, does the issuance of the note to the bank invoke Federal

jurisdiction through the Securities Exchange Act of 1934 and Rule 10(b)-5 to adjudicate claims of misrepresentation by the buyer against the seller?

2. If the foregoing question be answered in the affirmative, may relief in the form of cancellation of the note be given against the bank in the absence of any allegations that the bank participated in or was even aware of the alleged fraud?

## STATEMENT OF THE CASE.

The complaint alleged that plaintiffs purchased the business good will, merchandise and fixtures of the coin operated laundry and dry cleaning business of defendants, G. & G. Enterprises, Inc., Giselle Strausburger and Gladys Lucas, known as the Village Well of Justice, paying a portion of the purchase price in cash, assuming an existing chattel mortgage on the fixtures being sold, held by defendant, National Bank of Austin and borrowing additional funds from Austin to pay the balance.

More than nine months after consummation of the transaction and plaintiffs' receipt of the additional borrowing from Austin, plaintiffs filed this action, claiming violations by defendants other than Austin of Sec. 10(b) of the Securities Exchange Act of 1934 (15 USC, Sec. 78j [b]) and Rule 10(b)-5 promulgated thereunder.

The defendants other than Austin moved to dismiss on the grounds that no "security" was involved. Austin, while endorsing this view, sought dismissal on the basis there were simply no allegations of any wrongful conduct by Austin which would support an action even if a "security" was involved.

The District Court dismissed plaintiffs' Complaint on the basis that the facts alleged therein did not involve the purchase or sale of a "security" within the meaning of the Act.

The Seventh Circuit affirmed, holding that the promissory notes given by plaintiffs to the bank were not "securities" within

the meaning of the 1934 act and Federal jurisdiction was therefore lacking.

**ARGUMENT.**

Petitioners seek to invest a classic state court fraud action involving the purchase of a laundromat from two suburban housewives not only with a basis for federal jurisdiction, but also with such importance as should persuade this court to review the lower courts' denial of such jurisdiction by asserting 1) the case is an appropriate vehicle for deciding an allegedly important issue of securities law left open by this court in *Scherk* v. *Alberto-Culver Co.*, 417 U. S. 506, 41 L.Ed. 2d 270 (1974) and 2) an alleged conflict on the issue between circuits.

Baldly, this case involves the prosaic purchase of a business by Petitioners. They allege that facts were misrepresented in connection with the purchase. The sole basis of Federal jurisdiction asserted is the Securities Exchange Act of 1934 and Rule 10(b)-5 promulgated thereunder, and the statute and rule are invoked simply because the statute, in describing its coverage, uses the phrase "any note". Petitioners do not really make clear to the court that as between buyer and seller there was no note given or taken. On the contrary, as is the case in countless daily business transactions, the buyer went to a bank and borrowed funds to pay the seller. Since the buyers gave the bank a note evidencing their obligation to repay the funds, Petitioners contend that the Securities Act is thereby brought into play and federal jurisdiction properly invoked. Not only does the Court of Appeals' analysis of the situation remove all possible doubt of the correctness of the Court's decision, but the very statement of the proposition contains its own rebuttal.

The Court of Appeals recognized that the primary issue was " . . . whether the plaintiffs are simply borrowers in a commercial transaction who are not protected by the 1934 Act or investors in a securities transaction who are protected" As the guidepost of its search, the Court of Appeals cited this Court's hold-

ing in *S. E. C.* v. *National Securities, Inc.*, 393 U. S. 453, 466 (1969): ". . . in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality."

The Court then proceeded to analyze the facts in the light of a multitude of decided cases to determine whether Petitioners were investors, or simply borrowers. Recognizing that the fact of a borrowing was not itself conclusive inasmuch as the borrowing could be in the form of a large issue of debentures as opposed to a borrowing of a few dollars from a bank for an automobile, the Court held that each case must be determined upon its facts and that if the totality of the facts indicated that the notes were purchased as an investment the federal securities law would apply, but if the notes simply evidenced a borrowing from a third person of needed funds for a business, the act would not. In view of the most thorough and perceptive analysis made by the Court of Appeals in its decision, it would be an imposition upon this Court's time to gild the lily by attempting to restate the authorities and the considerations evidencing the correctness of the Court of Appeals' decision.

It should be noted, however, that the Court of Appeals' rejection of the concept that the use of a paper called a "note" was determinative of whether a "security" is involved is entirely consistent with this court's very recent decision in *United Housing Foundation, Inc.* v. *Foreman*, ..... U. S. ..... (June 16, 1975) that the use of a paper called "stock" is not determinative of whether a "security" is involved.

Not only do the Petitioners thus fail to establish Federal jurisdiction with respect to the Defendants other than the bank, but they do not even suggest a basis for a cause of action, federal or state, against the bank itself. There is no allegation in the Complaint that the bank was aware of any alleged misrepresentation, that the bank induced the transaction, or that the bank knew or even should have known that any representation or conduct out of the ordinary occurred. Thus, this Court is

asked to hold that where a bank loans money and takes back a note, the bank's right to payment depends not upon the Uniform Commercial Code, investing an innocent payee with the rights of a holder in due course and thus the right to recover from the maker even where the notes were executed as a result of fraudulent misrepresentation of fact (UCC 3-302, 305), but upon the Federal Securities Law and Rule 10(b)-5 which, because of the use of the note to evidence the obligation, nullifies the Commercial Code and, incidentally, its antecedents, the Uniform Negotiable Instrument Law and the Law Merchant.

Lastly, it is appropriate to comment on the two previously mentioned factors which Petitioners urge upon this Court as a basis for the issuance of a writ of certiorari.

It is suggested that in *Scherk* v. *Alberto-Culver Co., supra,* this court recognized the importance of the issue presented here and that this case presents a vehicle ripe for formulation of a general rule of law concerning the question left open in that case. Strangely, the "similarity" between the instant case and *Alberto-Culver,* in which the Seventh Circuit held that under the facts a security was involved, was not even adverted to by the Seventh Circuit in its decision in this case because of the wide factual differences.

Painting with the same broad brush, Petitioners suggest that the decision of the Second Circuit in *Movielab, Inc.,* v. *Berkey Photo, Inc.,* 452 F. 2d 662 (2d Cir. 1971), holding that notes issued by one publicly owned company to another publicly owned company for ten million five hundred thousand dollars, in exchange for the assets of the latter, constituted securities, is in such conflict with the holding of the Seventh Circuit that a note given to a bank to finance part of the purchase price of a laundromat is not a security that this Court must exercise its jurisdiction. We respectfully submit that neither proposed basis for the invocation of this court's jurisdiction under Rule 19 is sufficient under the facts of the instant case.

In *United Housing Foundation, Inc.* v. *Foreman, supra,* this court said:

> "In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as 'stocks' or 'bonds' will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument."

In the instant case, there is no suggestion whatever that the transaction underlying the issuance of the note had any of the significant characteristics typically associated with a security which would lead the parties to assume that the Federal Securities Law applied to their dealings.

While many cases may arise presenting "papers" issued under circumstances which would present the "gray areas" anticipated by this Court in *Foreman,* it must be clear that this is not such a case.

## CONCLUSION.

For the foregoing reasons and for the reasons apparent of record, respondents respectfully pray that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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